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IN THE

Supreme Court of the United States

October Term, 1956

No. ~~988~~ 120

DESSER, RAU & HOFFMAN and JACK L. RAU, individually,

Petitioners,

vs.

GEORGE T. GOGGIN, Trustee in Bankrupty of Stockholders Publishing Company, Inc., a bankrupt,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

BRIEF FOR RESPONDENT IN OPPOSITION.

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Question Presented for Review.

Where, in contemplation of bankruptcy, and in order to insure the ability to make essential priority disbursements, a corporation deposits its funds in a special trust account in the name of one of the members of the law firm which represents the corporation, may such firm of attorneys, one of whom is an officer and director of the corporation, after bankruptcy be permitted, upon a theory of set-off as defined in Section 68(a) of the Bankruptcy Act, to reimburse itself from said trust account for costs and expenses advanced on behalf of said corporation during the year preceding the opening of said trust account?

Statement of the Case.

A full perception of this case suggests the advisability of adding briefly to the Statement of the Case as presented by petitioners in their Petition herein. Not only was the subject special bank account opened on December 20, 1954, for the purpose of the protection of the incoming funds of the corporation and the making of certain essential disbursements therefrom, but two days previously, on December 18, 1954, the entire Board of Directors of the corporation, one of which directors was Arthur Desser, one of the petitioners, met to discuss the serious financial difficulty of the corporation and at that time authorize the filing of a Voluntary Petition in Bankruptcy on behalf of the corporation. On December 31, 1954, creditors filed an Involuntary Petition in Bankruptcy against the corporation. On January 5th, these petitioners remitted to the Receiver in bankruptcy all of the funds in said special account except the $3217.68. On January 21, 1955, petitioners filed with the Referee a Petition for an Order authorizing them "to reimburse themselves" out of the funds of the corporation in the special bank account, the sum of $3217.68 for moneys advanced in the year prior to December 18, 1954.

The Referee denied the Petition, holding that the funds in the special account constituted property of the bankrupt corporation, that Rau held only as Trustee or agent of the bankrupt corporation, and that there was no mutuality of debts or credits between the funds held by petitioners and the obligation of the bankrupt corporation for the funds advanced by petitioners.

As stated, the District Court affirmed the order of the Referee and approved and adopted his findings and conclusions. The Court of Appeals for the Ninth Circuit affirmed the judgment of the District Court.

Argument.

There is no adequate reason for the Supreme Court of the United States to grant the Writ requested.

The primary issue involves a determination of whether the factual situation herein gives petitioners a right of "set-off" within the meaning of Section 68(a) of the Bankruptcy Act, to funds of the bankrupt in the special trust account in the care of petitioners.

The trial court (*i. e.*, the Referee) ruled that this factual situation was not within the purview of Section 68(a)—that the subject funds were always the property of the bankrupt. The District Court, on review, affirmed on the same grounds. The Court of Appeals affirmed, pointing out that no right of set-off or any other right against the fund existed before bankruptcy and that clearly such a right could not be then established *after* bankruptcy.

It is submitted by respondent that petitioners do not set forth an adequate reason upon which this Court should base an allowance of the requested Writ. Petitioners assert that lower Courts need the "precise announcement" of this Court for guidance in future matters. Petitioners further assert that the "opinions of the various Courts of Appeal are not in such fundamental accord" on the subject matter of this case, and thereby imply a conflict in the Circuits. Thirdly, petitioners state that the instant case should be reversed because the opinion of the Court of Appeals for the Ninth Circuit was wrong. For the latter contention petitioners rely upon the case of *Half Moon Fruit & Produce Co. v. Floyd*, 60 F. 2d 709, a 1932 decision of the Court of Appeals for the Ninth Circuit. In its opinion in the instant case the Court of Appeals fully discussed its earlier decision in the *Half Moon Fruit* case

Produce case and clearly and easily distinguished it from the facts of the present case.

In their effort to invoke the interest and action of this Court petitioners in their brief cite cases from several Circuits dealing with questions of mutual debts and credits and set-off under Section 68(a) of the Bankruptcy Act. There are, of course, a multitude of cases dealing with the subject matter at hand. However, petitioners have completely failed to show that the opinion of the Court of Appeals in the instant case is in any material conflict with decisions of the Courts of Appeal of other Circuits.

As pointed out above, the chief case relied upon by petitioners in their opposition to the present ruling, is an earlier case in the same Ninth Circuit (*Half Moon Fruit & Produce Co. v. Floyd*, 60 F. 2d 799). In the *Half Moon* case, a commission merchant who had made seasonal cash advances to a grower to enable him to produce his crop was held to be entitled to an equitable lien on mellons consigned to him by the grower, and entitled to a "mutual credit" in the "set-off" sense for such advances against the proceeds from the sale of the mellons. The opinion of the Court of Appeals in the instant case distinguishes the *Half Moon* case, on at least two clear-cut grounds, and points out that in the absence of bankruptcy the petitioner law firm could not have asserted any lien against the money in the trust account, and further that the law firm had no beneficial interest in the trust account. The Court of Appeals rejected the theory of the petitioners that the occurrence of bankruptcy changed the nature of the fund and created a right to a set-off which had not previously existed.

There is, therefore, no such conflict on the subject point of law among the various Courts of Appeal that requires

the attention and action of the United States Supreme Court. While the subject matter of the instant case does involve a question of law under the Federal Bankruptcy Act, the question is not novel or unusually significant, and the Courts have thoroughly dealt with it. This Court itself has previously dealt directly with the subject matter of the instant case in the matter of *Western Tie and Timber Co. v. Brown*, 196 U. S. 502, 49 L. Ed. 571. In the latter case, the tie company and Harrison, the bankrupt, had been engaged in removing timber from the tie company's land, etc. The bankrupt operated stores, patronized by laborers of the tie company. The tie company deducted from the payroll the amount owed by the laborers to the bankrupt for purchases. Against a $24,000.00 debt owed to it by the bankrupt the tie company attempted to set off $2,210.73 collected from payrolls and held for the bankrupt. This Court held that the creditor could not set this off. The creditor was in a position of a trustee and therefore the case was not one of mutual credits and debts within the meaning of the set-off clause of the Bankruptcy Act. The authority of the *Western Tie and Timber Company* case has been respected and followed since it was handed down, and the Court of Appeals in the instant case recognized and specifically followed this authority.

Petitioners in their Petition herein (p. 13) seek to disengage themselves from the proposition that where the liability of one claiming a set-off arises from a fiduciary duty or is in the nature of a trust, the requisite mutuality of debts or credits does not exist, and such person may not set off a debt owing from the bankrupt to such liability. The petitioners assert (Pet. p. 7), but nowhere cite authority therefor, that their position is that upon the occur-

rence of the bankruptcy, the trust ceased and they merely had an "obligation to repay the remaining unexpended balance to the Receiver or Trustee." This proposition was answered in the Court below and the authorities have been referred to hereinabove. However, respondent desires to add one further thought on this point. Petitioners were not only fiduciaries by virtue of being trustees (through Rau) of the special bank account, but were fiduciaries also by virtue of Desser being an officer and director and attorney for the bankrupt corporation. The Board of Directors (including Desser) of the bankrupt corporation had recognized the hopeless insolvency of the corporation and had authorized the filing of a Voluntary Bankruptcy, even before the subject special bank account was opened.

A director of an insolvent corporation is a trustee for the creditors as well as for the corporation, and will not be allowed to use the trust property for his own benefit to the disadvantage of other creditors, nor will he be allowed to use his position with the superior knowledge or opportunity of acquiring information which it affords, to secure an advantage for himself over other creditors.

19 Corpus Juris Secundum 1108;

Hanson v. Choynski, 180 Cal. 275;

Nixon v. Goodwin, 3 Cal. App. 358.

If the partners (petitioners herein) had made any payments to themselves from the special account on account of the bankrupt's indebtedness to them, this would have been a breach of fiduciary duty to the bankrupt corporation and its creditors. It would have been a payment voidable under the California law pertaining to duties of corporate directors and officers, as well as being voidable under Section 60 of the Bankruptcy Act as a recoverable

preference. No such payment, of course, was made. At the time of bankruptcy, and now, the funds remained in the corporation's special account. Petitioners have been seeking to receive such a payment *after bankruptcy and by order of the bankruptcy court itself!* The Court of Appeals and the District Court have both held that the Referee was correct in refusing to permit and authorize such a payment to petitioners.

Conclusion.

Petitioners have failed to state an adequate reason for allowance of the Writ. For the reasons set forth hereinabove, the Petition for Writ of Certiorari should be denied.

ROBERT H. SHUTAN,
Counsel for Respondent.